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May 21, 2004

BY FACSIMILE AND FEDERAL EXPRESS

Elizabeth Miller Jennings, Esq.
Senior Staff Counsel
State Water Resources Control Board
Office of Chief Counsel
1001 I Street, 22nd Floor
Sacramento, California 95814

Re: Pacific Life Insurance Company's Petition for Review of Central Valley Regional Water Quality Control Board Cleanup and Abatement Order No. 05-2004-0044

Dear Ms. Jennings:

On behalf of Pacific Life Insurance Company, enclosed you will find a Petition for Review of the above-referenced cleanup and abatement order issued by the Central Valley Regional Water Quality Control Board on April 23, 2004. Although timely filed for jurisdictional purposes, Pacific Life hereby requests that the Petition be held in abeyance pending further notice.

Please do not hesitate to contact me should you have any questions.

Very truly yours,

Robert D. Wyatt

RDW:reb

Enclosure

cc (with enclosure):

June E. Knuth, Esq., Pacific Life Insurance Company
Ms. Debra Cunningham, Pacific Life Insurance Company

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Attorneys for Petitioner
PACIFIC LIFE INSURANCE COMPANY

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD

IN THE MATTER OF CLEANUP AND ABATEMENT ORDER NO. R5-2004-0044, ADOPTED APRIL 23, 2004, BY THE CENTRAL VALLEY REGIONAL WATER QUALITY CONTROL BOARD	Case No. PETITION FOR REVIEW BY PACIFIC LIFE INSURANCE COMPANY

TABLE OF CONTENTS

Page

I.

INTRODUCTION

Pacific Life Insurance Company ("Pacific Life"),[1] pursuant to Water Code section 13320 and 23 C.C.R. sections 2050 *et seq.*, hereby petitions the State Water Resources Control Board ("State Board") for review of the Central Valley Regional Water Quality Control Board's ("Regional Board") adoption of Cleanup and Abatement Order No. R5-2004-0044 ("CAO") on April 23, 2004, as to Pacific Life. A copy of the CAO is attached hereto as Exhibit A.[2] The CAO requires investigation and remediation by the named dischargers of PCE contamination allegedly resulting from historically distinct retail dry cleaning operations conducted at 1296 East Gibson Road, Woodland, California (the "Property"). The Regional Board's action was improper as to Pacific Life because (i) Pacific Life is not a discharger within the meaning of Water Code section 13304 as interpreted by decisions of the State Board; and (ii) Pacific Life is exempted from any cleanup liability by Health and Safety Code sections 25548 *et seq.*[3] Pacific Life is aggrieved in that it has been improperly named in the CAO and is required to perform remediation of contamination

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[1] Pacific Life Insurance Company, 700 Newport Center Drive, Newport Beach, California 92660, telephone (949) 219-3011.

[2] Also named as dischargers were Roebbelen Land Company, Mr. Hans Roebbelen, Mr. David Thuleen, Mr. Kenneth Roebbelen, Mr. Terence Street, Mr. George Carrere, Mr. Jerry Enwald, Ms. Caralee Enwald, Enwald Enterprises, Inc., and Bay Granite, Inc.

[3] A copy of Health & Safety Code sections 25548 *et seq.* is attached hereto as Exhibit B for ease of reference.

for which it is not factually or legally responsible. Pacific Life presented all of the issues contained herein, and evidence and authorities in support thereof, to the Regional Board before and at the hearing. Pacific Life petitions the State Board to rescind the CAO as to Pacific Life and to require the other named parties to perform the work required therein.

The issues presented in this petition are:

(1) Whether Pacific Life is a discharger as defined by Water code section 13304 and 23 C.C.R. section 2601; and

(2) Even if Pacific Life is a discharger within the meaning of Water Code section 13304, whether it is exempt from liability pursuant to the provisions of Health & Safety Code sections 25548 *et seq.*

II.
BACKGROUND

Pacific Life had no ownership connection with this site until June of 1998, when it foreclosed on the Property after its borrower, the mall's original owner, County Fair Associates, whose general partner was Roebbelen Land Company, defaulted on a $21 million loan from Pacific Life, secured by the Property. Pacific Life foreclosed on the Property in order to resell it to offset the financial losses arising from County Fair Associates' loan default. Although not relevant to the statutory analysis, Pacific Life did not have notice in fact of the PCE contamination until after it took possession of the Property.

In September of 1999, during Pacific Life's post-foreclosure marketing of the Property, a subsurface investigation performed by a prospective buyer discovered contamination beneath a portion of the site ("Pad I") that had been used for many years as a retail dry cleaning outlet operated by several different owners. Pacific Life immediately notified the Yolo County Health Department and the Regional Board upon receiving a copy of the prospective buyer's Phase II Report which documented this contamination, and then commissioned an investigation to ensure that the then current tenant, Bay Granite, Inc. ("Bay Granite"), was operating its dry cleaning business responsibly and was not contributing to the contamination. A report on this investigation of Bay Granite operations was provided to Pacific Life on August 8, 2000, and was subsequently submitted to the Regional Board. The report did not find that Bay Granite's operation was causing or contributing to contamination. At no time did Regional Board staff (a) inspect Bay Granite operations; (b) cause Bay Granite to cease operations; (c) conduct a field investigation of the contamination; or (d) request Pacific Life to terminate the Bay Granite lease. Nevertheless, Pacific Life initiated negotiations with Bay Granite to terminate its lease prior to its termination and vacate the premises, even though the investigation provided no evidence to prove that Bay Granite was causing discharges of PCE. Pacific Life took these steps out of an abundance of caution which resulted in the early termination of Bay Granite's operation in September 2001. After prospective buyers declined to purchase the entire Property because of the contamination, Pacific Life was able to sell the balance of the shopping center property to a third party in December

1999 by retaining ownership of Pad I. Since that time Pacific Life has been unable to sell the remaining contaminated parcel, which remains unmarketable until remediated.

Since first learning of the contamination in the September 1999 Phase II Report, Pacific Life has been working cooperatively with the Regional Board on a voluntary basis to address the problem. This voluntary process culminated in a commitment by Pacific Life to install a Soil Vapor Extraction and Treatment ("SVET") system and operate it for six months. Through its consultant, Pacific Life installed the SVET system, which began operating on July 18, 2003, and ran for six months. Results from the operation of the SVET and rebound test were submitted to the Regional Board on March 12, 2004, which Board staff acknowledge demonstrate a very substantial reduction of PCE in the soil. (Transcript of April 23, 2004, Regional Board Hearing (copy attached hereto as Exhibit C; hereinafter referred to as "Tr.") 67:7-13.) After reviewing the SVET results, Regional Board staff found that a majority of the PCE had been removed from the property's soils. Pacific Life has expended approximately $600,000 in conducting this work voluntarily, without contribution from any other party.

Throughout the course of its work at the site, Pacific Life has maintained its position that it has proceeded voluntarily, and that it is statutorily exempted from cleanup liability by the lender liability exemption contained in Health and Safety Code sections 25548 *et seq.* (discussed in detail below). In doing so, Pacific Life consistently requested Regional Board staff to require that the actual dischargers – none of whom have yet performed or contributed to any remedial activities – be held accountable. The Regional Board staff's continued failure to pursue and require the actual dischargers to perform work resulted in Pacific Life's declining in the Spring of 2004 to conduct further voluntary remedial activities. This position was further necessitated because Regional Board staff refused to make a determination as to whether the lender liability exemption is applicable to Pacific Life unless made in the context of CAO proceedings. (Tr. 35:23-36:8.) This stalemate lead to the Regional Board preparing a draft CAO and, after a continuance, setting a hearing date to consider formal adoption of the CAO. On April 22 and 23, 2004, the Regional Board held a noticed hearing pursuant to 23 C.C.R. sections 648 *et seq.* and Government Code sections 11400 *et seq.* and then adopted the CAO and assigned it the number R5-2004-0044. Pacific Life contends this order was adopted in error because the evidence does not support the finding that Pacific Life is a discharger as defined, and the Regional Board misconstrued and misapplied the relevant provisions of the lender liability exemption set forth at Health & Safety Code sections 25548 *et seq.*

III.
STATEMENT OF POINTS AND AUTHORITIES

A. Pacific Life is Not a Water Code Section 13304 Discharger.

The Regional Board may issue Section 13304 cleanup and abatement orders to any person "who has caused or permitted, causes or permits, or threatens to cause or permit any waste to be discharged or deposited where it is, or probably will be, discharged into the waters of the state." (Water Code § 13304, subd. (a).) Persons subject to this provision are designated as a "discharger," which is defined as "any person who discharges waste which could affect the quality of waters of the state." (Cal. Code Regs., Title 23, § 2601.) Accordingly, if Pacific Life is to be subject to the provisions of a CAO, it must first be found to be a discharger as defined, which it is not.

The State Board has interpreted the Water Code and its implementing regulations to apply, in certain circumstances, to landowners who purchase contaminated property, even where the landowners have no prior knowledge of the contamination and the actual release of pollutants occurred pre-purchase. (*See In the Matter of the Petitions of Arthur Spitzer, et al.*, Order No. WQ 89-9 (SWRCB 1989).) This interpretation, which holds that such landowners are committing an "ongoing discharge," is based upon the following reasoning: If the landowner "knows of a discharge on his property and has sufficient control of the property to correct it, he should be subject to a cleanup order." (*Id.*) Thus, a landowner that has knowledge of the discharge and the ability to control it is a discharger pursuant to the Water Code. Significantly, however, the "ongoing discharge" interpretation has not been held to apply to landowners that actually do control the discharge.

The "ongoing discharge" interpretation was employed by the Regional Board in the CAO in a forced attempt to provide legal footing for Pacific Life's alleged liability and, toward that end, at the hearing, Regional Board staff counsel argued that the Board could infer that discharges occurred after Pacific

Life took title to the property in June of 1998. (Tr. 14:20-15:3.) In making this argument, Board staff counsel implied that a 1997 Phase I Report delivered to Pacific Life during the foreclosure proceedings imputed sufficient, actual knowledge of contamination at the Property. This contention is patently incorrect. The Phase I Report did no more than note a "recognized environmental concern" due to the observation of stains on the dry cleaner's floor and because of the ten year history of dry cleaning operations at the Property. The Phase I Report did not conclude that a discharge had occurred. Rather, the Report recommended that further investigation be conducted at some future time. Such language is routinely included in Phase I Reports involving dry cleaning operations and does not establish whether contamination exists in fact. (Tr. 108:7-109:8.) Pacific Life thus had no knowledge of any discharge, ongoing or otherwise, until September of 1999 when its prospective buyer's Phase II investigation was conducted. In this regard, Pacific Life testified at the April 23 hearing that it is the custom and practice to have buyers conduct such environmental due diligence investigations. (Tr. 97:1-11; 98:14-99-1.)

Regional Board staff counsel also argued that Pacific Life had the ability to control the discharge. (Tr. 15:4-9.) Left out of counsel's argument is the fact that Pacific Life did indeed undertake to control the discharge. Upon obtaining knowledge of the contamination in September 1999, Pacific Life immediately notified the Board and immediately implemented a groundwater investigation and monitoring program. Additionally, Pacific Life has been extremely proactive in voluntarily pursuing PCE source removal through its operation of the SVET system and has reduced substantially the amount of contaminants in the soil, thereby reducing the risk to groundwater. Regional Board staff have agreed with this fact. At the hearing Regional Board staff testified that a "majority of the PCE mass was removed . . . " from the soil by Pacific Life (Tr. 9:4); and "Pacific Life has been very cooperative . . . they have conducted investigation and they have conducted soil vapor extraction" (Tr. 30:22-24). Pacific Life, upon obtaining knowledge of the contamination, immediately controlled the ongoing discharge of the waste. Accordingly, Regional Board counsel's argument lacked merit, and section 13304(a) does not apply to Pacific Life. Pacific Life is not liable for the cleanup of the Site under the precedent of State board decisions.

The work performed by Pacific Life in reducing PCE soil contamination also excludes it from coming within the intent of State Board decisions regarding "ongoing discharges," which is to prevent the uncontrolled spread of contamination. Those decisions are based on circumstances where new landowners purchase property and then, without conducting any cleanup, assert that they are not liable as dischargers. Here, Pacific Life has acquired title to the Site through foreclosure solely to protect its security interest and has taken substantial steps towards remediating the contamination. The policy rationale of assigning discharger liability to prevent an ongoing discharge does not apply where, as is the case here, a landowner that did not cause the discharge has undertaken to reduce significantly the spread of contamination.

At the mistaken urging of its staff, the Regional Board has refused to acknowledge the distinction between a landowner that takes no action in connection with its contaminated property and a landowner that undertakes voluntary investigative and remedial actions pending staff's investigation and enforcement against those parties which have actual legal responsibility. Water Code section 13304 is not a strict liability provision as to landowners and, accordingly, the Regional Board staff, as prosecutors, had the burden to prove that Pacific Life is liable as a discharger. (Evid. Code § 115.) The only contention argued by Regional Board staff as to how section 13304 applies to Pacific Life relied on recital of standard "ongoing discharge" language which, as demonstrated, does not apply on the undisputed facts. (CAO page 7, ¶ 35.) This failure to address how a landowner that controls a discharge can at the same time be asserted to be permitting an ongoing discharge underscores the Regional Board staff's failure to meet its burden of proof and the mistaken findings of the Regional Board itself.

B. Pacific Life is Exempt from Water Code Liability <u>Pursuant to Health & Safety Code Sections 25548 *et seq.*</u>

In 1996, the California Legislature adopted Health and Safety Code section 25548 et seq. to resolve "uncertainty in the law. . . with regard to the liability of lenders for hazardous material contamination involving property that is owned or used by borrowers." (Health & Safety Code § 25548, subd. (a)(1).) This case marks the first occasion this statute has been construed. The provisions of the statute relevant to this Petition allow lenders with a security interest in property that is contaminated to foreclose on that property without subjecting such lenders to cleanup liability. This lender liability exemption is based on the legislative policy determination that a "credit or fiduciary relationship is not sufficiently related to the hazardous material contamination to warrant, as a policy matter, the imposition of liability on lenders and fiduciaries." (Health & Safety Code § 25548, subd. (a)(3).) Importantly, the statute does not require a foreclosing lender to inspect property before foreclosing, and the liability of the lender is not based on, or affected by, whether the lender conducted or required an inspection prior to foreclosure. (Health & Safety Code § 25548.1, subd. (k)(3).) Hence, even if a lender had knowledge of contamination before foreclosure, that fact in and of itself would not nullify the statutory exemption. To hold otherwise would lead to the absurd result that a lender could never foreclose on a contaminated property, and a defaulting borrower could fail with impunity to repay its loan.

To determine whether Pacific Life had satisfied the statutory criteria contained in the lender liability exemption, the Regional Board was asked by Pacific Life at the hearing to consider and decide the following three determinative questions based on the evidence:

(1) Whether Pacific Life promptly reported any known or suspected releases to the responsible agency;

(2) Whether Pacific Life promptly suspended operations with respect to that portion of the property where the known or suspected release occurred

or may occur and removed hazardous materials from the suspended operations; and

(3) Whether Pacific Life undertook to divest itself of the property within a reasonable time.

(Health & Safety Code §§ 25548.4 subd. (h) and 25548.5 subd. (a).)

With respect to the first question, prior to the April 23, 2004 hearing on the CAO, Regional Board staff maintained that Pacific Life had failed to report promptly a suspected release based on Pacific Life's possession of the 1997 Phase I Report that identified the *potential* for PCE contamination because of the observed dry cleaning operations at the shopping center. At the hearing, however, testimony was introduced from Pacific Life's experienced environmental consultant that such cautionary language in Phase I reports does not typically trigger agency reporting requirements and that further investigation is still required to confirm or refute the basis for the noted "environmental concern." (Tr. 108:7-22.) After such further investigation did in fact establish PCE contamination, Pacific Life notified the Regional Board. Thus, the statutory prompt reporting requirement was satisfied, and the CAO does not contain a finding to the contrary.

With respect to the second and third questions, the Regional Board found that Pacific Life did not promptly suspend Bay Granite's operations and that it did not undertake to divest itself of the Property in a reasonably expeditious manner. (CAO page 8, ¶ 37.) These findings are unsupported by the evidence and are in error. The CAO itself properly finds that the contamination occurred prior to 1997, but no evidence was produced to establish that Bay Granite's operations in fact also discharged PCE. With respect to undertaking expeditiously to divest itself of the Property, Pacific Life followed the exact language of the statute. In making its erroneous finding, the Regional Board read into the lender liability exemption additional requirements unsupported by the statute's text or purpose.

C. The Regional Board's Finding That Pacific Life Failed to Promptly Suspend Operations Is in Error.

The lender liability exemption requires lenders who have foreclosed on contaminated properties to promptly suspend "operations with respect to that portion of the property where the known or suspected release or known or suspected threatened release occurred or may occur." (Health & Safety Code § 25548.4.) Presumably, this provision was drafted to apply to situations in which the operation that caused the actual release remains on the foreclosed property. Here, however, the operation that caused the actual release filed for bankruptcy and had vacated the Property in 1997, over a year before Pacific Life foreclosed on it.[4] Thereafter, Pacific Life's borrower leased the space to another dry cleaner, Bay Granite, *before* the foreclosure. The result of these actions was that the dry cleaning operation that caused the release was no longer at the site but was replaced by Bay Granite, a new business entity. At the hearing, the chronology

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4 The Regional Board found that the release "must have occurred prior to 1997." (CAO page 4, ¶ 15.) Accordingly, the release must have occurred prior to Bay Granite's tenancy.

of these events, their significance, and Pacific Life's responsibilities in connection with them, became the subject of confused reasoning by the Regional Board and its staff.

The questions regarding Bay Granite's operations before the Regional Board were (i) whether Pacific Life was required to suspend immediately Bay Granite's operations despite the fact that no evidence exists that it had in fact caused the discharge or release of PCE; and, if so, (ii) was Pacific Life's suspension "prompt" within the meaning of the statute and in the context of the facts as reasonably understood by Pacific Life. Since the inception of this matter Pacific Life has maintained that in the absence of persuasive evidence that Bay Granite operations were in fact causing a discharge of PCE, Pacific Life was under no duty or ability to terminate summarily Bay Granite's operations, but proceeded with early lease termination negotiations out of an abundance of caution consistent with the circumstances.[5]

Pacific Life took this position because, as previously noted, it had itself undertaken to investigate through a consultant whether Bay Granite had contributed and was contributing to the contamination. (Tr. 89:14-90:4.) The investigating consultant advised Pacific Life that there was inadequate evidence to prove a discharge of PCE from Bay Granite operations. The consultant did find

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5 The ability of a foreclosing lender to cease unilaterally its borrower's pollution operations is clearly distinguishable from terminating a borrower's tenant operations which are being conducted pursuant to the rights and obligations set forth in the lease documents.

that Bay Granite's dry cleaning machine "appeared to be in good condition with no visible or obvious seriously worn parts or defects." (Further Investigation of Dry Cleaners, page 5, August 8, 2000.) The investigation found no "open containers of wastewater" and no "obvious stains or unusual odors . . . in or around the dry cleaning machine or the boiler room at the time of the site visit." (*Id.*, page 6.) Accordingly, at that time, Pacific Life's own investigation provided insufficient evidence upon which to base a finding that Bay Granite was releasing PCE into the environment. While the consultant's investigation did reference a 1999 Phase I Report that apparently notes past questionable housekeeping procedures, Bay Granite's facility was clean and well run at the time Pacific Life's consultant inspected it, and thus there was no factual basis for Pacific Life to assert that Bay Granite was in breach of its lease. After engaging in subsequent discussions with its attorney and the consultant that performed the investigation, Pacific Life concluded that it could not prove that Bay Granite had discharged PCE from its facility. (Tr. 90:5-91:11.) Regional Board staff's efforts to call into question Pacific Life's business judgment some five years after the fact deserve no weight or consideration. Had Bay Granite's operations caused a discharge, the time for Regional Board to so contend and take action was in 1999, not April 2004.

In contrast to the investigative efforts taken by Pacific Life, Regional Board staff conceded under oath that they had never so much as inspected Bay Granite's operations to ascertain whether a discharge of PCE was occurring or could occur. (Tr. 26:9-12.) Nonetheless, Regional Board staff asserted, and the Regional Board found, that Bay Granite did release PCE based on two documents, neither of which contains evidence of an actual release of PCE by Bay Granite operations. The first document is the 1999 Phase I Report referenced subsequently by the authors of the "Further Investigation of Dry Cleaners." Apparently, this Phase I Report was completed a month before the Phase II Report that documented contamination and opined that the conditions and practices at Bay Granite appeared to be similar to those at Service Cleaners operated by a prior owner in 1997. However, the 1999 Phase I Report is not in the administrative record. (Tr. 99:2-18.) Moreover, the sworn testimony by witnesses at the hearing was that neither the Regional Board, Regional Board staff nor Pacific Life personnel have ever seen the 1999 Phase I Report and, accordingly, references to it and reliance upon it in the CAO are improper. (Gov. Code § 11425.50, subd. (c) ("factual basis for decision shall be based exclusively on the evidence of record in the proceeding . . .").) This evidentiary rule exists for good reason. Regional Board staff based its finding that Bay Granite caused a discharge on the 1999 Phase I's purported identification of open buckets of wastewater. (Tr. 38:24-39:25.) However, Regional Board staff admitted to having no knowledge as to whether those buckets contained any PCE, thus basing its entire discharge theory on assumption of facts impossible to ascertain. (Tr. 39:5-13.) Finally, even if the 1999 Phase I Report were in the record it would not constitute evidence of a release; rather, it would denote no more than a "recognized environmental concern" requiring further investigation, just like the 1997 Phase I Report.

In an attempt to shore up its position, Regional Board staff offered into evidence a study entitled Linn and Mixell, *Reported Leaks, Spills and Discharges at Florida Dry Cleaning Sites*, in support of the proposition that releases of PCE *may* result from equipment failures. That proposition is not in dispute. However, as noted above, the only evidence in the record that speaks to the equipment at Bay Granite explicitly states that the dry cleaning machine "appeared to be in good condition with no visible or obvious seriously worn parts or defects." (Further Investigation of Dry Cleaners, *supra*, page 5.)

Regional Board staff's assertion that Bay Granite released PCE, and the Board's adoption thereof as a finding, are thus based on a document that is not in the record (and, if it were, does not contain any actual evidence of a release), and a report from Florida that is irrelevant to this matter. Regional Board staff never inspected Bay Granite's operations and, until the eve of the hearing, never seriously contended that Bay Granite had released PCE. Indeed, Regional Board staff did not seriously contend Bay Granite had discharged PCE at the hearing either. When asked whether there was any evidence of a Bay Granite discharge, Regional Board staff replied, "[w]e don't have direct evidence" (Tr. 27:14-19) and "[w]e are saying that there *could* have been a discharge" (Tr. 37:11-16 (emphasis added)). Accordingly, the finding that Bay Granite did discharge PCE (CAO page 7, ¶ 34) is based only on surmise and speculation and must be stricken.[6]

Because there was no persuasive evidence that Bay Granite had in fact caused the contamination, or was in violation of its lease, Pacific Life had no other option except to enter into good faith negotiations with Bay Granite for an early lease termination rather than initiating eviction proceedings in court. Such, not surprisingly, are the requirements of California contract and real property law. The filing of a lawsuit for eviction or termination of the lease without sufficient cause could have subjected Pacific Life to significant liability for damages because it would have been contrary to law. Pacific Life had been informed by its attorney and consultant that it could not prove that Bay Granite had caused or contributed to the discharge and, accordingly, had no legal basis upon which to base a lease default claim.[7] (Tr. 90:5-91:11.) (*See also* June 21, 2000, letter from Bay Granite's attorney to counsel for Pacific Life (copy attached hereto as Exhibit D), stating Bay Granite was in compliance with its lease and

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[6] This finding must also be stricken because it improperly states that Bay Granite actually caused or permitted a release. Regional Board staff only offered testimony alleging that Bay Granite could have caused a release and the record thus contains *no* evidence that Bay Granite *did* release PCE. (*Compare* Tr. 37:11-16, "[w]e are saying that there could have been a discharge from Bay Granite" *with* CAO page 7, ¶ 34, "Bay Granite . . . caused or permitted waste to be discharged to waters of the state . . . .")

[7] While Regional Board staff has made much of the 1999 Phase I Report referenced in the Further Investigation of Dry Cleaners, the use of such "evidence" in an eviction proceeding by Pacific Life would have been precluded by Evidence Code section 1200 subdivision (b) as it is plainly hearsay.

requesting any information to the contrary.) Bay Granite was well aware of this issue and raised the issue in the lease termination negotiations. (Tr. 92:12-21.) In light of these facts, an eviction action most likely would have led to a lengthy and unsuccessful legal proceeding which would have extended Bay Granite's occupancy of the site. To its own financial detriment, Pacific Life negotiated the termination of Bay Granite's lease. Pacific Life did, under these facts, make prompt, good faith and effective efforts to suspend Bay Granite's operations, which the Regional Board should have found based on the evidence.

Regional Board staff offered no alternative scenario as to what, on these facts and circumstances, would have been an appropriately prompt method for Pacific Life to pursue. The Regional Board's findings in the CAO imply that immediate suspension of Bay Granite's operations was necessary, presumably achieved by alleging lease violations in an eviction proceeding. However, the statute simply cannot be read to require parties to initiate dubious lawsuits in order to qualify for the exemption. (*See Halbert's Lumber, Inc. v. Lucky Stores, Inc.*, 6 Cal. App. 4th 1233, 1239 (1992) ("words should be interpreted . . . in accord with common sense and justice, and to avoid an absurd result").) Prompt suspension clearly means that operations must be suspended using the reasonable method that is most prompt given the circumstances surrounding those operations. Indeed, had the legislature intended otherwise it could have easily specified a time frame in which "suspensions" have to be completed, but it wisely did not. Here, the circumstances include the fact that there is no actual evidence that Bay Granite released PCE, the contamination at the site is of a "garden variety" presenting no real human health threat and, importantly, the site was being investigated and monitored during the time that Pacific Life was negotiating with Bay Granite, thereby ensuring no further impacts were occurring.

In sum, Pacific Life, unlike the Regional Board, has no police power and had to choose between negotiation and litigation when it sought to suspend Bay Granite's operations. Because negotiation was its only viable legal option, Pacific Life chose that method and was ultimately successful.

D. The Regional Board's Finding That Pacific Life Did Not Undertake to Divest Itself of the Property Is in Error.

The lender liability exemption states that the exemption shall not apply if "after foreclosure or its equivalent is conducted, the lender does not undertake to sell . . . or otherwise undertake to be divested of the property in a *reasonably expeditions* manner. . . " (Health & Safety Code § 25548.5(a) (emphasis added).) Notably, this provision does not require the actual sale of the contaminated property; rather, it requires the lender only to undertake to divest itself of the property. The statute then expressly provides how undertaking to sell in a reasonably expeditious manner is accomplished: "the *exemption* set forth in subdivision (a) of Section 25548.2 *shall apply* following foreclosure or its equivalent, if, within twelve months following foreclosure or its equivalent, the lender . . . [l]ists the property for sale, re-lease, or other disposition with a broker, dealer or agent who deals with that type of property." (Health & Safety Code § 25548.5(a)(1) (emphasis added).) Uncontroverted evidence presented to the Regional Board and its staff before and at the hearing shows that Pacific Life listed the Property for sale with a broker within 12 months of foreclosure. (Tr. 94:24-95:12.) This evidence would seemingly end discussion on that aspect of the statute's application to the facts.

However, Regional Board staff argued, and the Regional Board found, that the lender liability exemption did not apply because "Pacific Life did not after foreclosure undertake to be divested of the property in a reasonably expeditious manner." (CAO page 8, ¶ 37.) Though nothing in the CAO indicates how this provision was not complied with, arguments made by Regional Board staff counsel at the hearing imply that the finding in the CAO was based on the fact that Pacific Life sold the bulk of the shopping center property but retained Pad I, the parcel on which the dry cleaning operations took place.[8] Pad I was originally included as part of that sale but was removed when the buyer refused to proceed because of the contamination. (Tr. 116:18-117:6.) Such action is not prohibited by the statute and, as a matter of law, Pacific Life satisfied the "undertake to divest" provision when it listed the entirety of the Property with a broker within 12 months of foreclosure.

Regional Board staff's argument regarding divestment relied on the premise that Pacific Life could have simply discounted the value of the

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[8] The failure to state the factual basis for this finding is a violation of Government Code section 11425.50(b), which provides that if "the statement is no more than mere repetition or paraphrase of the relevant statute or regulation, the statement shall be accompanied by a concise and explicit statement of the underlying facts of record that support the decision." Because the Regional Board merely paraphrased the relevant statute, the State Board must strike the finding at CAO page 8, ¶ 37.

Property in order to entice a buyer: "the statute requires lenders to do everything commercially reasonable to transfer the property quickly. That transfer would presumably be to a buyer . . . *at a discount* so they can clean up the property." (Tr. 16:5-10 (emphasis added).) That argument is not only financially simplistic and incorrect, it directly conflicts with express language in the statute, which provides that the exemption does not apply only if the lender rejects "an offer of fair consideration for the property acquired through foreclosure." (Health & Safety Code § 25548.5, subd. (l).) Fair consideration means the sum of, *inter alia*, the value of the security interest, any unpaid interest, rent or penalties and the lender's costs incurred for any removal or remedial action. (*Ibid.*) The legislature thus directly provided that a lender such as Pacific Life did not have to wait for a buyer willing to pay a steeply discounted price for the entire Property, if in fact any such buyer could be found.

The Regional Board staff has apparently inferred some nefarious purpose in the parceling of the Property, but Pad I was always a separate assessor parcel and it had always been contemplated that there could be different ownership of the mall and Pad I. (Tr. 116:1-14.) Pacific Life certainly did not separate Pad I to shield itself from cleanup costs- it has subsequently spent almost $600,000 dollars of its own money on voluntary remediation efforts for property that may not be worth that much in a cleaned up state. (Tr. 102:21-103:1.) Moreover, the statute expressly contemplates partial sales of property. When a lender calculates what "fair consideration" for a property would be, it must subtract "[a]ny amounts received by the lender in connection with any partial disposition of the property." (Health & Safety Code § 25548.5, subd. (*l*)(B)(i).) The statute thus provides that a lender can sell a property in separate parcels, which is eminently reasonable given that the sale of contaminated property is extremely unlikely.[9]

Finally, the record is clear that despite there being no requirement to do so, Pacific Life *did* try to sell the property at a discount, and that those efforts failed due to the contamination. (Tr. 116:18-117:2.) The Regional Board's finding is thus in error on two grounds: (i) Pacific Life complied with the statutory test of listing the property with a broker within twelve months; and (ii) Pacific Life satisfied the Regional Board's groundless requirement that it attempt to sell the property at a discounted price.

E. The Regional Board Did Not Understand the Statute and Relied on Inaccurate Staff Interpretations in Making Its Decision.

The hearing record reflects instances in which the Regional Board, unable to decipher the "complexities" of the lender liability statute, deferred to its staff's interpretations and comments regarding the statute's application to the facts. (Tr. 166:5-17.) This unwarranted deference to staff proved problematic for two reasons. First, Regional Board staff has no expertise to defer to in interpreting the lender liability statute in a matter of first impression. The record is clear

[9] The day before Regional Board staff testified that the statute required Pacific Life to sell the property at a discount and that Pacific Life could not sell separate parcels, Regional Board staff sent Pacific Life a letter citing Health & Safety Code section 25548.5 subd. (*l*), which is contrary to both of those propositions.

that Regional Board legal staff resisted engaging in a rigorous analysis of the statute for over four years. Second, numerous of Regional Board staff's comments and interpretations were transparently incorrect and were advanced for the sole purpose of preventing Pacific Life from invoking the exemption consistent with the statute and its underlying legislative policy.

The most notable of misinterpretations came from the Executive Officer in his summation and recommendation, who, after informing the Regional Board that he had no idea what the legislature intended to accomplish with the lender liability exemption or whether it applied to Regional Board actions, offered a statement explaining that the legislature could not have intended "that parties who are involved in sites in some fashion are then somehow able to walk away from that site and leave it to the state." (Tr. 150:19-151:3.) Not only is this observation a straw man, the legislature spoke directly to that point: "[i]t is the intent of the Legislature, in enacting this chapter, to specify the type of lender and fiduciary conduct that will not incur liability for hazardous material contamination." (Health & Safety Code § 25548, subd. (b).) The Executive Officer thus testified that the lender liability exemption could not have been intended to do exactly what the legislature said it should do: exempt certain lenders from cleanup liability, so long as they meet certain criteria, which Pacific Life has done.

This comment, and others,[10] were highly prejudicial to Pacific Life. The Regional Board often defers to its staff in regard to technical matters as well as interpretations of regulations promulgated pursuant to the Water Code. That deference should not extend to Regional Board staff's interpretations of a statute that it has no expertise in and has no authority to administer. Regional Board staff's lack of expertise is apparent from the record, which is riddled with misinterpretations of the lender liability exemption.[11]

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[10] *See, e.g.,* Tr. 20:10-11, "closed loop systems leak, and they had leaked at this site." There is no evidence of a leak from the closed loop system in the record; Tr. 149:23-150:1, "the machine basically has a lot [sic] opportunities for leaking filters or plugged filters or valves or connections that are leaking . . . ." The only evidence in the record regarding the condition of the closed loop dry cleaning machine noted that it "appeared to be in good condition with no visible or obvious seriously worn parts or defects." (Further Investigation of Dry Cleaners, *supra*, page 5); Tr. 144:17-22, "I submit there is ample evidence in the record that there was a seamless use of inappropriate housekeeping process for chemicals on the site, started out in the 1997 Phase [I] Report, continued through all the other documents that have been mentioned." To the contrary, the August 8, 2000 "Further Investigation" described closed wastewater containers and an odor- and stain-free work area; Tr. 147:15-21, "There is a municipal well . . . nearby . . . [w]e believe there is vertical continuity . . . ." Regional Board staff notified area residents that there was no hydrogeologic connection between the plume and any municipal water wells.

[11] *See, e.g.,* Tr. 16:5-10, transfer of property at a discounted price. The statute contains no such requirement; Tr. 147:3-7, "Pacific Life should have . . . pursued . . . other options such as selling the property at a discount to allow cleanup consistent with the statute and the intent of the statute." Again, the statute does not require any such discounting and expressly contemplates recovery of the entire amount of the outstanding loan; Tr. 17:23-18:1, "Whatever benefit Pacific Life got from listing the whole property, it lost it by acting inconsistent with listing and selling just part of the property . . . ." The statute provides for partial dispositions of property; Tr. 12:5-8, "Pacific Life did not conduct [a soil sampling survey] prior to taking ownership of the land and mall." The statute says, explicitly, that no such prior work is required; Tr. 16:21-22, "in layman's terms, that means the lender must sell the property

(footnote continued)

The lender liability statute is fundamentally different from the Water Code and conflicts with the Regional Board's policy of naming every potential discharger in its cleanup and abatement orders. This does not mean that the Regional Board should be permitted to rely on any conceivable argument, whether based in law and fact or not, to preclude its application. The legislature has determined that a certain class of lenders is exempt from the liabilities associated with hazardous materials contamination on properties that they have foreclosed on. Pacific Life is in that class and the Regional Board's strained and factually unsupported application of the lender liability exemption must be reversed.

IV.
SUMMARY AND CONCLUSION

After obtaining knowledge that the property was contaminated, Pacific Life immediately controlled any ongoing discharges through its investigation and remediation of the PCE. Pacific Life was not required to undertake these activities and did so as a good corporate citizen. The Regional Board refused to recognize this and applied the lender liability statute in a manner unsupported by law and fact.

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as soon as possible." The statute requires that the lender undertake to sell, which is entirely different from actually selling and reflects the legislature's understanding that sales of contaminated property range from difficult to highly unlikely.

Based on the facts of this case and for all of the foregoing reasons, Petitioner Pacific Life respectfully requests the State Board to grant its Petition and to rescind the CAO as to Pacific Life.

Dated: May 21, 2004

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